The Federal Report

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

The Month in Washington: February 2007

Congress slowed as the presidential race heated up, entering a customary period where major policy initiatives or themes come from the campaign trail, not the Capitol. Many in the political classes were amazed to see a stimulus package, even if of questionable value to some, move from Presidential proposal to law with a speed not seen for many years. Yet this event did not herald a new era of cooperation, as Congress and the Administration continued to disagree on solutions for the housing market's doldrums, for example. Healthcare reform continued to grow in importance as a campaign issue, with political leaders beginning in earnest to frame the debate for the people. The courts ruled on several significant issues for pension funds including 401(k) liability and protection for medical device makers.

Issues and Events

President Bush: Employers Should Report Healthcare Costs to Workers

Employers should tell their workers what is being spent for their healthcare, according to the Administration, which has proposed posting that cost in a box on the employee's W-2 form. The idea is included in the FY 2009 budget proposal.

Making employees aware of the cost to their employers fits with the President's vision that healthcare can be reformed by consumers acting in a marketplace to lower costs and improve services. The first step on this path is informing consumers, who do not bear the cost of their coverage directly and thus may be unaware of it. The Administration believes lack of information may be causing "inefficient choices of health coverage, including overconsumption of health coverages by employees." Like other conservative approaches to health reform, the Administration believes that workers should seek out, buy, and maintain their own coverage and be given the tax incentives to do so.

As a basic sort of informative disclosure, the W-2 figure would be a number representing the total plan use (medical, dental, optical, as appropriate) for an average, similarly-situated, comparably covered employee. The initiative is not intended to produce a precise individualized cost number based on actual utilization.

403(b) Not Part of Bankruptcy: Southern Ohio

The U.S Bankruptcy Court for the Southern District of Ohio found that 403(b) assets were not part of the Chapter 7 bankruptcy being considered. The court found that trust assets are not part of a bankruptcy if there are limits on transfer under non-bankruptcy law, under the theory that the non-transferable property is not an asset as the bankruptcy laws envision that term. The ruling involves 403(b) property held by OhioHealthPlan. The same court found differently in another 403(b) case where a participant in an annuity system run by VALIC because it did not believe the annuity arrangement constituted a trust since the participant did not have a legal title to the money in their account. The case is *Rhiel v. OhioHealth Corp*. (In re Hunter), Bankr. S.D. Ohio, No. 03-68413, 1/24/08.

Lenders Leery of Bankruptcy Mortgage Rewrite

Congress will consider allowing bankruptcy judges to alter mortgage terms for primary homes in an attempt to cushion the foreclosure effects of the subprime mortgage melt-down. The U.S. Senate may vote on such a proposal (S. 2136, but also part of S. 2636) soon, but that has also been predicted for most of February without result.

Proponents – who include the Democratic leadership, civil rights groups, and the AARP – claim the new law could save as many as 600,000 people from losing their homes. "We should be giving families every reasonable tool to ensure they can keep a roof over their heads," said Senator Dick Durbin (D-IL), the top Senate Democrat after Majority Leader Harry Reid (D-NV). Durbin is the Senate sponsor of the measure; the House Judiciary Committee passed a similar bill last year. The coalition of public supporters of the bill said in a letter to the Hill that, "The court-supervised modification provision is a commonsense solution that will help families save their homes without any cost to the U.S. Treasury, while ensuring that lenders recover at least what they would in a foreclosure."

The Bush Administration and the industry oppose the measure, the combination of which should suffice to derail the proposal given Senate rules. The White House considers the bill an imprudent restriction on an already shaky market while the banks contend that providing borrowers with an escape hatch today creates risk that the borrowers of tomorrow will have to shoulder through higher rates and fees to offset the new lending hazard.

Should this issue become the latest in a long line of stand-offs between the White House and Congressional Democrats, Hill leaders may have to confront the fact that the public has consistently, and by large margins, expressed opposition to any effort that could be construed as a bailout. A December, 2008 Wall Street Journal/Harris Interactive poll found a plurality of those surveyed opposed government help for subprime "victims" by 42% to 25%, with many undecided.

Unanimous Court Allows 401(k) Lawsuits

An uncommonly united Supreme Court ruled on February 20 that individual participants in a 401(k) plan may sue the plan for mismanagement, reversing a lower court opinion that individuals only have this cause of action when the "entire" plan has been affected.

The case, *LaRue v. DeWolff*, involves claims by James LaRue that his former employer ignored his investment instructions and caused him to lose $150,000 when he told them to shift his savings from stocks to cash just prior to the popping of the internet bubble. This ruling overturns the reading of ERISA established in a 1985 case, where the Supreme Court found that ERISA is mostly concerned with issues that involve the entire plan and provides remedies that address damage to the entire plan.

Justice John Stevens, writing for the majority, noted that the changing retirement landscape and the dominance of defined contribution plans made a new interpretation of the defined-benefit-oriented 1985 ruling necessary. Joined by Justices David H. Souter, Ruth Bader Ginsburg, Stephen Breyer, and Samuel Alito on the main opinion, Stevens wrote that, "For defined contribution plans, however, fiduciary misconduct need not threaten the entire plan's solvency to reduce benefits below the amount that participants would otherwise receive. Whether a fiduciary breach diminishes plan assets payable to all participants or only to particular individuals, it creates the kind of harms that concerned (ERISA Section) 409's draftsmen."

Chief Justice John Roberts and Justice Anthony Kennedy largely agreed with the main opinion but stressed in a concurring opinion that employees such as LaRue should have to use established plan procedures first to be made whole (such as asking the plan administrator to correct the mistake) before resorting to the courts.

The Bush Administration argued for the employee side of the conflict. Assistant Solicitor General Matthew Roberts asserted that supporting the rights of an individual participant improves the plan as a whole by keeping the provisions of ERISA strong through enforcement. The Labor Department also reacted positively. "Today's decision supporting our position is a huge victory for workers and retirees," said Labor Secretary Elaine Chao.

But opponents of the decision promised negative effects. Defendant counsel said that, "Ultimately, employers aren't going to sponsor plans if they're going to be sued every time they make an innocent mistake." Other business spokesmen envisaged a torrent of lawsuits related to plan mistakes.

However, the Court left open questions about what procedures employees should follow before turning to the judicial system for redress. It remains to be seen if employers will raise procedural barriers to protect the plan against effective action by participants that will bring Congressional action. There has been no significant negative reaction from Congressional sources, suggesting that there is a consensus that the Court's ruling does not need further definition at this time.

The ruling is *LaRue v. DeWolff,* Supreme Court 06-856.

California Congressional Delegation

Speaker Nancy Pelosi (D-CA, San Francisco) distinguished herself as a Congressional leader in many of the month's exchanges with the Administration, where most of the action occurred outside of the regular order. On the economic stimulus package, Pelosi concluded the baseline deal with the President and, although wanting according to some of the left of her party, the deal became the cornerstone of a swiftly successful initiative to address the slumping economy. As part of a delicate balancing act, Pelosi assuaged her left wing by declining to bring up legislation to reauthorize the Foreign Intelligence Surveillance Act (FISA) demanded by the White House and passed by the Senate.

Related National and Industry News

New Budget: Big Cuts, Many Freezes, Still $400 Billion Deficit

President Bush released his last budget on February 4. The document aims to make a stand for fiscal discipline through several tough budgeting choices, an elusive goal for most of the Bush presidency. Despite cuts and spending freezes in many departments and an effort to contain the growth of Medicare, the $3 trillion budget still forecasts deficits of $400 billion in 2008 and 2009, up from $163 billion in 2007.

Defense receives a 5% increase (costs for the ongoing wars in Iraq and Afghanistan are not fully included in the figure released) but nearly every other budget area will see reductions in real terms. Significantly, the budget plan does propose changes to Medicare to control costs that are scheduled to explode based on baby-boom generation retirements and escalating healthcare costs. The Bush budget hopes to save $170 billion in payment freezes to Medicare over 5 years and even Medicare Advantage, the private providers in the Medicare system that have been staunchly defended by the President from cuts as recently as last year, would be affected.

Congress passed an emergency stay to the currently scheduled Medicare provider cuts as one of the last "emergency" bits of legislation done in 2007. Every time the implementation date for scheduled cuts to provider reimbursements has approached, Congress has acted to delay the cuts; last year, proposed cuts were replaced by provider *increases*. Providers contend that they are barely making a living on Medicare patients as it is and respond to any proposed cut by stating that they will either stop accepting new Medicare patients or stop participating in the program entirely.

The Bush budget features a host of cuts to popular programs ranging from education to health promotion, and its overall goal of holding domestic discretionary spending to $1 trillion combine to make it a non-starter in Congress, as Presidential budgets have been for many years. Budgets do, however, act as discussion points over priorities and approaches to solving problems, and President Bush's final contribution to the discussion is no exception.

Administration Must Offer Medicare Legislation Under Trigger

Circumstances activated a previous law when the Medicare trustees forecast that the program will need at least 45% of its funding from general government revenue in the next two years. Under the law, the Administration must offer a plan when those conditions are met.

Secretary of Health and Human Services (HHS) Mike Leavitt said the Administration would use the opportunity to go beyond the requirements of the law and offer a broader reform proposal. The Bush plan will likely build on the philosophy espoused in the State Children's Health Insurance Program (SCHIP) debate, that opening up markets and employing consumer choice will bring the needed improvements in value. Leavitt confirmed as much by citing the Administration's plan for a reform measure emphasizing a "private market where consumers choose, where insurance plans compete and where innovation drives the quality of health care up and may drive the cost down" rather than a "Washington-run, government-owned plan, where government makes the choices, sets the prices and [then] taxes people to pay the bill."

Like most budgets, the FY 2009 proposal from President Bush was pronounced dead on arrival. Democrats, particularly on the House side, are already leery of the Medicare Advantage approach to Medicare and are unlikely to approve expansion of private plans servicing the government program. The President's plan may still serve as an interesting discussion point and as an attempt to combine the best ideas of the GOP on Medicare reform into a coherent plan, perhaps as a position for the presidential elections.

Stimulus Package Becomes Law

President Bush signed a $152 billion stimulus package, intended to stave off a recession with a short-term binge of consumer spending. The final bill provides for a $600 tax rebate to individual taxpayers, or $1,200 for married taxpayers filing jointly, with an additional $300 for each child of an eligible taxpayer. The payouts are reduced for incomes over $75,000 but the Senate version prevailed in allowing Social Security and veterans benefits to count toward the $3,000 income floor, making seniors and disabled service members eligible for the rebate. The cost of the plan will be added directly to next year's deficit, which is projected to approach $400 billion, up from about $190 billion this year.

As the price for passing the legislation with such alacrity, Congressional leaders raised the possibility of a "Stimulus II" bill later this year. That legislation would include various proposals skipped in the "emergency" bill such as extended unemployment insurance and food stamps, and increased spending on infrastructure. The Stimulus II bill would also likely become a vehicle for a host of pet projects loosely tied to the theme of "stimulus" (in that they are Federal spending into the economy), including further Federal support for the housing market, investment in alternative energy, an increase in the Federal match to Medicaid to help the States, and other more esoteric initiatives. The President would almost certainly veto such a measure without negotiation.

Parties, Not Candidates, Present Contrast on Healthcare

The Presidential primaries are heading toward a conclusion, allowing policy hounds to look ahead to the coming fight in the general election. Regardless of which of the pair of remaining viable candidates wins the nomination of their party, the general election will feature a healthcare choice of "As Good As Congress Gets" versus "Free Enterprise Will Solve This Problem, Too."

All four of the remaining viable candidates believes in more aggressive use of technology to drive down costs, and thus hopefully prices, and in focusing more attention on prevention. Ironically, these provisions often provide the funding and savings offsets for health reform plan spending on subsidies, new research priorities, and other changes. Even Congress cannot spend the same money twice, so enacting health insurance technology this year, for example, would mean the funds in a reform budget could not be counted again.

Chronic diseases consume some 70% of healthcare spending, according to an editorial that ran in the Miami Herald authored by former Senator Bill Frist (R-TN), a medical doctor, and ex-director of the Congressional Budget Office (CBO) Dan Crippen. These experts call for changes in Medicare compensation to favor diagnostic procedures and on health reform that stresses "personal responsibility" in lifestyle. Senator Obama referred to this issue on February 19 in Texas when he called for "less of a disease care system and more of a health care system," and all the remaining candidates are on record favoring a prevention emphasis. The details of such an approach could vary wildly based on larger reform goals, the money willing to be spent, definition of terms such as "personal responsibility," and numerous other factors.

Both Democrats, Senators Hillary Clinton (D-NY) and Barrack Obama (D-IL), offer plans that lean heavily on the Federal Employees Health Benefit Program (FEBP) as a model. The FEBP offers a variety of options in a schedule, allowing the Federal workforce to select the combination of coverage and cost they think best. Obama would mandate the coverage of children but does not explicitly call for mandatory coverage of all Americans and some see these principles as more moderate, and thus more politically feasible, than the Clinton approach.

In the February 21 debate in Texas, the Democratic candidates discussed the issue at some length. "If you do not have a plan that starts out attempting to achieve universal health care, you will be nibbled to death, and we will be back here with more and more people uninsured and rising costs," Senator Clinton contended.

Republicans John McCain, Senator from Arizona, and Mike Huckabee, former Governor of Arkansas, would bring market reforms through deregulation. Conservatives have long held that prices are being distorted by government interference and have sought reforms such as allowing consumers to use out-of-state insurers; gutting the list of procedures that must be covered to allow consumers to decide what services they need for themselves; using market forces to combat over-utilization; and cracking down on bogus lawsuits that encourage "defensive medicine," tests and procedures of minimal value ordered as a way to protect the provider from liability.

Healthcare has been a significant issue for the American people, and the potential recession will compound apprehension about costs and coverage. With health reform certain to be a centerpiece of the general election campaign the winner could enter office with a sufficient mandate to break the current impasse on health issues.

Google Enters EHR Market

Internet fixture Google began a pilot project with the Cleveland Clinic to host medical records for several thousand people. The electronic health records (EHR's) will be protected with a password. The company joins Microsoft and Revolution Health (founded by former AOL star Steve Case) in establishing experimental programs to explore the viability – and potential profitability – of the EHR market. As third parties, Google and other vendors are not covered by the Health Insurance Portability and Accountability Act (HIPAA), a cause for concern among medical privacy advocates.

More commercial involvement in EHR's and health information technology can only improve the political atmosphere for a Federal solution, or Federal leadership on issues such as privacy and data standards.

Fed Approval Process Protects Medical Device Makers: Supreme Court

The Supreme Court ruled 8-1 on February 20 that devices that have passed the premarket approval process of the Food and Drug Administration (FDA) are shielded from State-based liability. Justice Ruth Bader Ginsberg dissented. The case, *Riegel v. Medtronic*, involves a man who died during an angioplasty in 1996.

Justice Antonin Scalia wrote for the majority that Federal law, here the device approval process of the Food and Drug Administration (FDA), preempts State liability laws. Only the pre-market approval process – the most painstaking of those used by FDA – provides this protection based on the preemption clause of the 1976 Medical Device Amendments. Long-time students of this area of law may recall that the 1976 law came in response to enormous problems with the Dalkon Shield IUD and lead to the rigorous testing requirements for medical devices found today. Among its other provisions, the '76 Amendments forbid States from attaching any other standards "different from, or in addition to," the Federal statute.

The ruling applies only to Type-III devices, which have gone through the toughest of the review processes, and has no bearing (at the moment) on FDA approved drugs.

Scalia also noted these devices are intended for very sick people and that the FDA has a central role in evaluating benefits versus risks for them. Juries are not appropriate vehicles in this context, he said, because it "sees only the cost of a more dangerous design, and is not concerned with its benefits; the patients who reaped those benefits are not represented in court." Scalia noted that patients "would suffer without new medical devices if juries were allowed to apply the tort law of 50 states to all innovations." The Admini-

stration had also argued that allowing tort actions through State channels undermined the FDA's authority.

Some Hill Democrats disagreed. Congressman Henry Waxman (D-CA, Santa Monica) said of the decision, "The Supreme Court's decision strips consumers of the rights they've had for decades. This isn't what Congress intended, and we'll pass legislation as quickly as possible to fix this nonsensical situation."